2003 BELTWIDE COTTON CONFERENCES, NASHVILLE, TN – JANUARY 6-10

THE WASHINGTON UPDATE

Wayne Bjorlie
Farm Services Agency
Washington, DC

Abstract

This paper presents political and economic developments, including rising deficits and international pressures, that may affect the direction of the farm program in the future.

Discussion

Disaster aid for the 2002 crop was stalled last fall in Congress mostly because the Administration insisted that any money spent on it must be offset by a spending cut somewhere else in the budget. The main impetus for disaster aid then was political—the election was coming up, and control of congress was at stake. However, it stalled. It was later expected to come up during the Lame Duck session, but most of the issues that had been discussed for that session were overshadowed by the need to fund military activity and by the Lott controversy. Disaster aid was not very high on the radar screen on the Hill.

In the new Congress, the control issue has been settled, for a while. The incentive for passage of disaster aid is weaker than it was. Congress knows the public's memory is short, and it's two year until the next election. War and tax cuts are main agenda items. Social issues such as confirmation of judges will consume a lot of energy. There is no over-riding reason for a majority in congress to vote for aid, and the administration has said that agriculture has received enough help already. It is hard to see disaster aid happening this year.

Agriculture has received a large commitment from Congress—no doubt about that. The latest estimate is that the 2002 farm bill will cost an average of $16 billion every year through 2007, the end of the current law. It will be most expensive Farm Bill in history, if it happens.

The next slide is about 6 months old because the most recent estimate of the deficit has not yet been released. However, with increased spending in other areas of the budget, such as defense, and with tax cuts being proposed on top of the increase, the budget deficit cannot help but rise.

Concern over the budget deficit started getting serious in the Reagan administration about 20 years ago. It took almost 20 years to get back into a surplus situation, thanks to huge tax receipts from the booming economy of the 1990s. Now, the surplus is gone again. This likely implies no new farm benefits, and perhaps a struggle to maintain the ones we have.

Even with no change in legislation, we could lose some program benefits through changes in Administration policy in response to rising deficits and the need for money elsewhere in the budget.

The present use of certificates in redeeming loans could change. Not many realize it, but the current usage of certificates is based solely on an administrative decision that was made in the last administration. There were two very strong views presented during that debate. One was to value the certificates at the AWP, thus providing a marketing loan value that would not be subject to the payment limit. That is, of course, the way the decision went. The other view was that the certificates should be valued at the original loan rate, providing no marketing loan gain and completely aborting the usefulness of the certificates in loan redemptions. This decision could be reversed administratively in the future.

Overall cotton program costs are not expected to decline much this year, compared to last year. Marketing loan costs are expected to be around $1 billion this year, compared to $2.5 billion last year, when the AWP got down around 20 cents and the LDP or POP got to about 30 cents. This year, the counter-cyclical payment is likely to take of the slack left by the declining marketing loan costs.

Marketing loan benefits declined lately with the rise in the A Index.

Farm income takes a double hit when prices rise and reach the loan level. We have not seen this phenomenon for about 10 years, when we last had both marketing loan benefits and a target price deficiency payment. For every 1-cent rise in prices, farm revenue actually drops by about 1 cents because 1 cent is lost in marketing loan gains and another cent is lost in counter-cyclical payments. This double whammy operates for a fairly short time when prices are around the loan rate. Then, it reverts to a loss of only 1 cents, offsetting the gain of 1 cent in the market.

Thus, under the new US farm program, rising world prices may provide a greater incentive for producers in other countries to increase production, while they provide virtually no additional incentive for US producers at certain price levels.

US share of the world "need" for cotton may decline as the A Index begins to rise.

In addition to the budget deficit as a possible threat to the US program, I would add that globalization may also become a threat. The US cotton program is already under attack in various international fora. It is routinely criticized by other producing countries whose subsidy programs cannot be as generous. The basic argument is that the US subsidy program makes it possible for US farmers to pay less attention to prices and still produce surpluses that then depress world prices further. This is becoming a PR problem for the United States.

I recently read an interview with Mr. Kerekou, the president of Benin. The interview was mostly about the turmoil now being seen in West Africa, but the report also asked him if he was prepared to act on recommendations by international bankers that Benin reduce assistance being given to its cotton farmers. His answer: I cannot afford to reduce support as long as the United States maintains its support at such high levels. We are forced to take whatever price is dictated by others.

Such views reflect the overall view that the United States is flexing its muscles internationally in an irresponsible way that disregards the needs of small countries. No other country can spend $2.5 billion per year supporting cotton production. Some resent that we do that. Leaving aside the merits of the argument about farm subsidies, other over-riding considerations in world affairs may dictate changes in US farm policy in the future.

Here are a few examples of policies that grate on foreign cotton interests:

Step 2 is now under direct attack in the WTO as an illegal export subsidy. We do not have to argue about whether it is or it isn't an export subsidy. What is actually happening with it today?

As the 2002 crop year winds down, the Step-2 payment rate is being driven upward by a shortage of Memphis Territory middling 1-3/32. The 6 cents the program is generating, however, can be used to export anything from the finest SJV Acala to motes. Many qualities are not in short supply.

Here's another example. All of the producers in the room recognize this phenomenon. When you take out a loan on your cotton, the loan rate is adjusted for the class of the bale. When you repay the loan, the AWP also is adjusted by that same amount so that most bales receive the same marketing loan gain. However, it appears that there is additional gain from the market because of the loan schedule's inaccuracy in reflecting actual market conditions at the time the loan is repaid.

The market discounts are less than the discounts in the loan schedule. The market premiums are greater than the premiums in the market. Therefore, the marketing loan program allows for additional gain beyond merely the loan rate minus the AWP. That is one of the sources of loan equity in a bale of cotton.

These benefits of the cotton program are not secrets. They are well understood by those who would attack your program to limit its scope and its role in the welfare of the American cotton industry. The cotton program, perhaps, has become too successful for its own good.

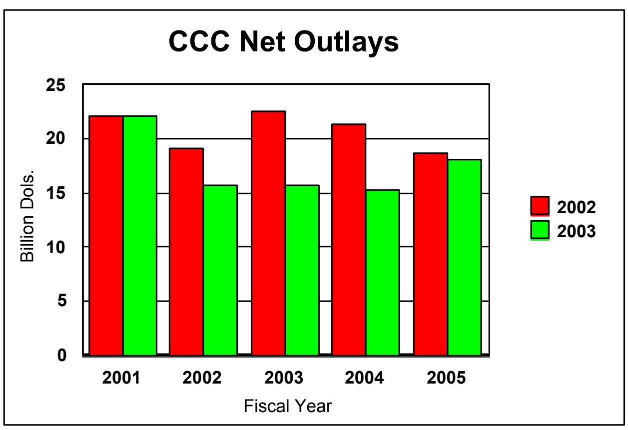


Chart 1.

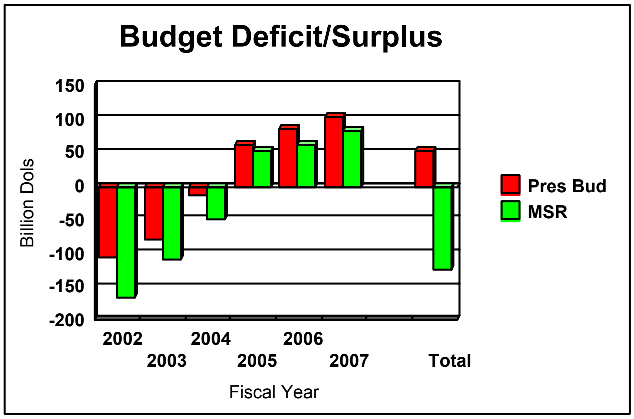


Chart 2.

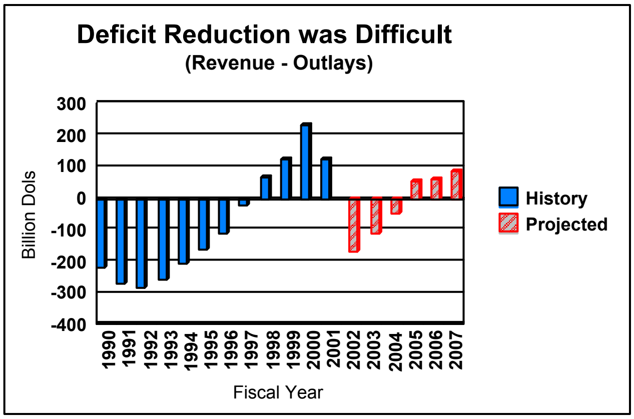


Chart 3.

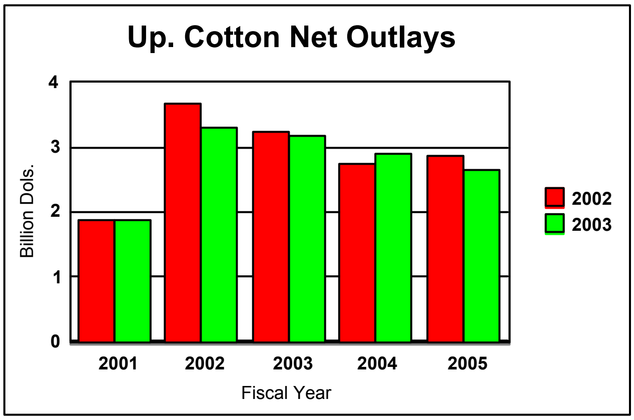


Chart 4.

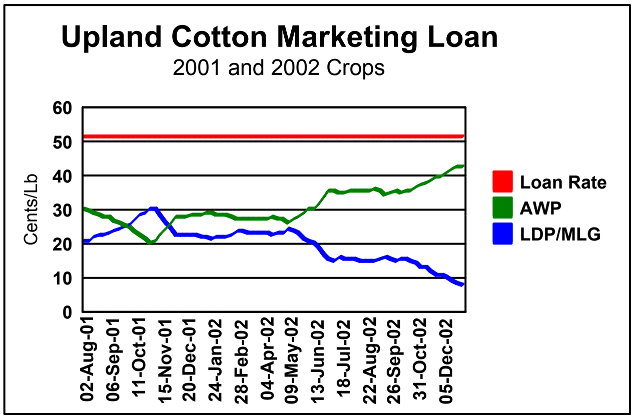


Chart 5.

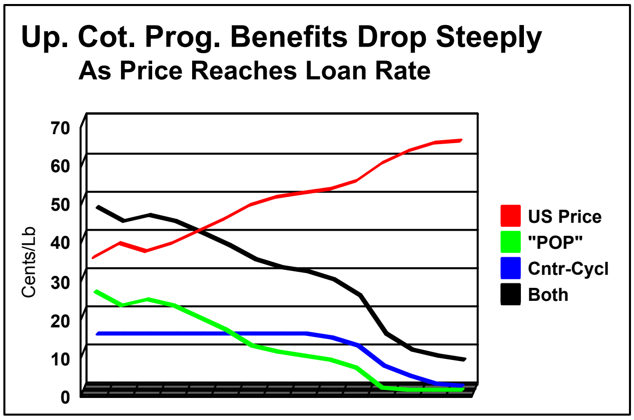


Chart 6.

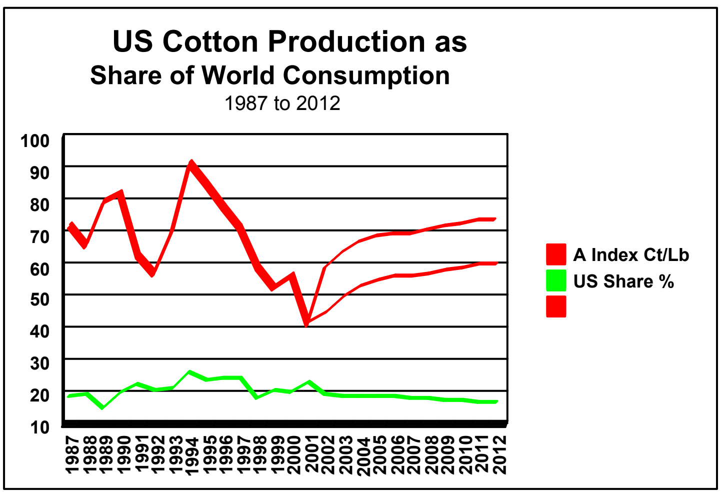
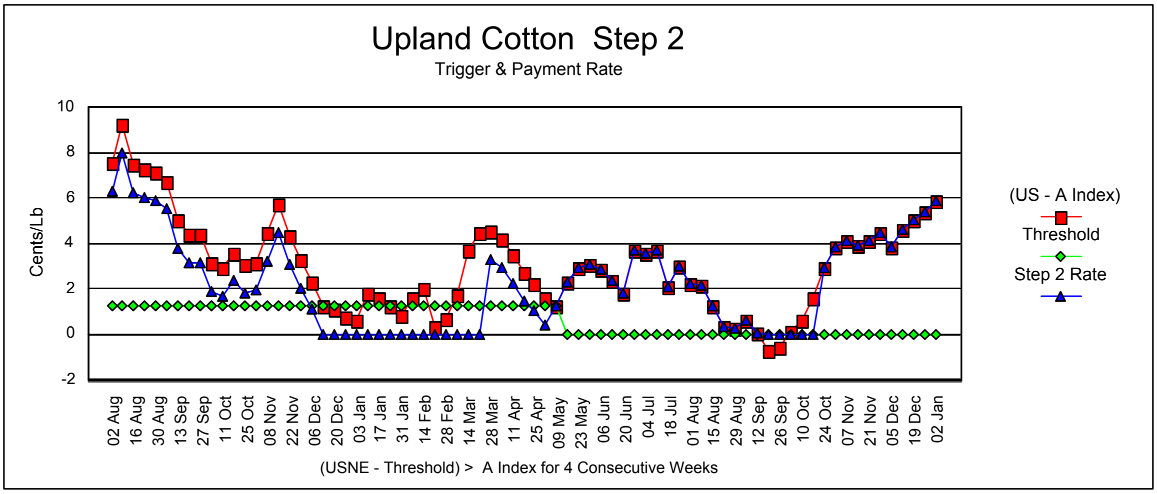
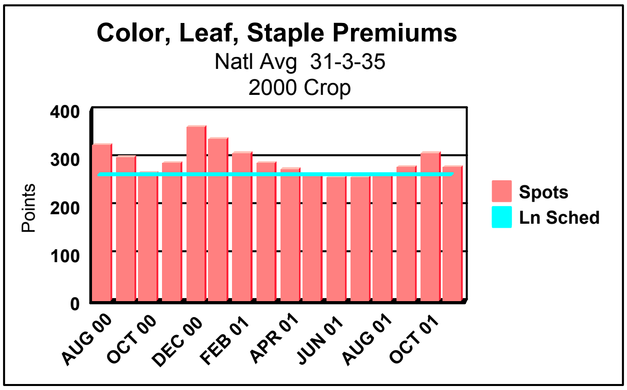


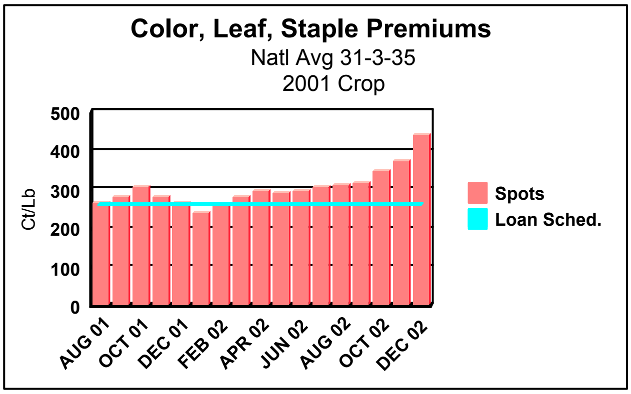
Chart 7.

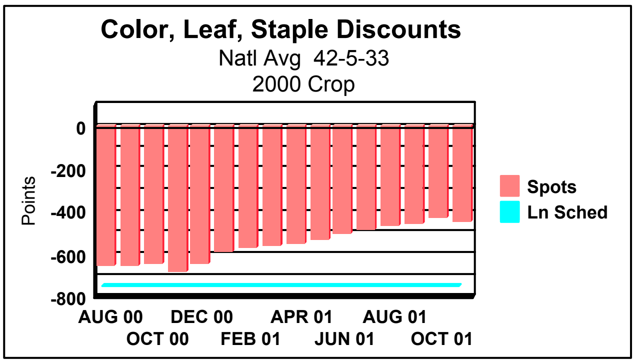


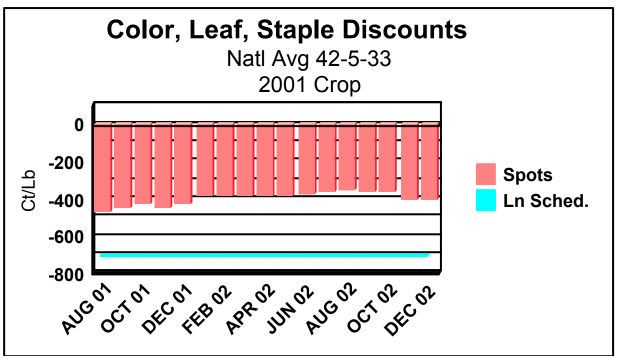
Upland Cotton Step 2
Trigger & Payment Rate
Cents/Lb
10
8
6
4
2
0
-2
02 Aug
16 Aug
30 Aug
13 Sep
27 Sep
11 Oct
25 Oct
08 Nov
22 Nov
06 Dec
20 Dec
03 Jan
17 Jan
31 Jan
14 Feb
28 Feb
14 Mar
28 Mar
11 Apr
25 Apr
09 May
23 May
06 Jun
20 Jun
04 Jul
18 Jul
01 Aug
15 Aug
29 Aug
12 Sep
26 Sep
10 Oct
24 Oct
07 Nov
21 Nov
05 Dec
19 Dec
02 Jan
(US - A Index)
Threshold
Step 2 Rate
(USNE - Threshold) > A Index for 4 Consecutive Weeks

Chart 8.


Color, Leaf, Staple Premiums
Natl Avg 31-3-35
2000 Crop
Points
400
300
200
100
0
AUG 00
OCT 00
DEC 00
FEB 01
APR 01
JUN 01
AUG 01
OCT 01
Spots
Ln Sched


Color, Leaf, Staple Premiums
Natl Avg 31-3-35
2001 Crop
Ct/Lb
500
400
300
200
100
0
AUG 01
OCT 01
DEC 01
FEB 02
APR 02
JUN 02
AUG 02
OCT 02
DEC 02
Spots
Loan Sched.


Color, Leaf, Staple Discounts
Natl Avg 42-5-33
2000 Crop
Points
0
-200
-400
-600
-800
AUG 00
DEC 00
APR 01
AUG 01
OCT 00
FEB 01
JUN 01
OCT 01
Spots
Ln Sched


Color, Leaf, Staple Discounts
Natl Avg 42-5-33
2001 Crop
Ct/Lb
0
-200
-400
-600
-800
AUG 01
OCT 01
DEC 01
FEB 02
APR 02
JUN 02
AUG 02
OCT 02
DEC 02
Spots
Ln Sched.

Charts 9 – 12.